

Message Text

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PAGE 01 KATHMA 00291 170747Z

21

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SUBJ: NEPALESE ACCESS TO SPECIAL DEVELOPMENT RESOURCES

REF: KATHMANDU 0185

1. SUMMARY: EMBASSY HAS BEEN GIVEN MEMORANDUM BY MINISTRY OF FINANCE OUTLINING IMPACT OF ENERGY CRISIS ON NEPAL'S ECONOMY. (TEXT POUCHED NEA/INS AND EB/FSE.) WE ASSUME MEMORANDUM HAS BEEN PREPARED FOR USE DURING MEETING OF SPECIAL DEVELOPMENT COMMITTEE OF IMF/IBRD. MEMORANDUM STATES THAT ENERGY SITUATION WILL HAVE GRAVE IMPACT ON NEPALESE ECONOMY IN VIEW OF LOW LIVING STANDARD IN NEPAL, STAGNATION IN AGRICULTURAL PRODUCTION, UNFAVORABLE BALANCE OF TRADE, AND UNIQUE DIFFICULTIES IN TRANSPORTATION AND COMMUNICATION FACED BY NEPAL. COMMENTS BELOW BASED ON MEMORANDUM AND GENERAL READING OF ECONOMIC SITUATION HERE.
END SUMMARY

2. ACCORDING TO FINANCE MINISTRY MEMORANDUM WITH 90 PERCENT OF POPULATION INVOLVED IN AGRICULTURE, WHICH STILL ACCOUNTS FOR TWO-
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PAGE 02 KATHMA 00291 170747Z

THIRDS OF NEPAL'S GROSS DOMESTIC PRODUCT, DEVELOPMENT OF NEPAL'S

ECONOMY DEPENDS PRIMARILY ON PROGRESS IN AGRICULTURAL SECTOR. GON HAS BEEN FOLLOWING POLICY OF EMPHASIZING NEED FOR IMPROVEMENTS IN TRADITIONAL AGRICULTURAL PRACTICES, PRIMARILY THROUGH GREATER USE OF AGRICULTURAL INPUTS. THIS HAS INCLUDED USE OF BETTER SEEDS, FERTILIZERS, IMPORTS OF MODERN AGRICULTURAL IMPLEMENTS SUCH AS TRACTORS AND EXPANDING AREAS UNDER IRRIGATION. AS EXAMPLE, TOTAL NUMBER OF TRACTORS IN NEPAL HAS INCREASED FROM 794 IN 1970/71 TO 2,025 IN 1973/74. WITH REGARD TO FERTILIZER, CATTLE MANURE IS STILL MOST WIDELY USED FOR OF FERTILIZER. HOWEVER, USE OF CHEMICAL FERTILIZERS HAS INCREASED RAPIDLY FROM LEVEL OF 11,600 METRIC TONS IN 1968/69 TO PROJECTED LEVEL OF 60,500 METRIC TONS IN 1974/75. FACED WITH INCREASING POPULATION AND STAGNATION IN AGRICULTURE PRODUCTION, GON HAD PLANNED FOR FURTHER INCREASES IN USE OF FERTILIZERS OVER NEXT FIVE YEAR PERIOD.

3. HOWEVER, WITH IMPACT OF ENERGY CRISIS AND RAPID RISE IN LEVEL OF PRICE OF IMPORTS, GON IS EXTREMELY HARD PRESSED TO CONTINUE ITS DEVELOPMENT EFFORTS IN AGRICULTURE. DUE TO HIGH COSTS OF TRANSPORTATION, COST OF FERTILIZERS IN NEPAL IS MUCH HIGHER THAN COST FOR SIMILAR PRODUCTS IN INDIA. GON FIGURES INDICATE THAT FERTILIZER PRICES HAVE TRIPLED SINCE 1972/73. FURTHER, AS RESULT OF SHORTAGES IN SUPPLY OF PETROLEUM PRODUCTS AND RISE IN PRICES, TRACTORS AND IRRIGATION PUMPS ARE NOT NOW BEING FULLY UTILIZED, WITH RESULT THAT AGRICULTURAL FIELDS ARE SUFFERING. WHILE IT IS TRUE THAT AREAS SUBJECT TO IMPROVED AGRICULTURAL PRACTICES IN NEPAL REPRESENT SMALL PROPORTION OF TOTAL CULTIVATED AREA, GIVEN NEED TO INCREASE AGRICULTURAL PRODUCTION TO FEED GROWING POPULATION AND TO GENERATE IC EARNINGS NEEDED FOR IMPORT OF DEVELOPMENT GOODS FROM INDIA, ANY DECLINE IN AGRICULTURAL PRODUCTION HAS IMPORTANT AND IMMEDIATE IMPACT ON ECONOMY.

4. EFFECT OF INCREASING PETROLEUM PRICES IS EXACERBATED IN NEPAL BECAUSE OF NEPAL'S UNIQUE GEOGRAPHY. NEAREST SEAPORT TO NEPAL IS CALCUTTA, AT DISTANCE OF 400 MILES. WITHIN NEPAL, GEOGRAPHY IS EXTREMELY RUGGED, RESULTING IN LOWER GASOLINE MILEAGE AND LESS EFFICIENT UTILIZATION THAN IN COUNTRIES WITH LESS SEVERE GEOGRAPHY. COST OF TRANSPORTATION BETWEEN LIMITED OFFICIAL USE

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PAGE 03 KATHMA 00291 170747Z

CALCUTTA AND NEPAL NORMALLY RANGES FROM TEN TO 100 PERCENT OF C.I.F. PRICE CALCUTTA DEPENDING ON NATURE OF COMMODITY. COST OF TRANSPORTING PETROLEUM PRODUCTS OVERLAND FROM CALCUTTA TO NEPAL IS ABOUT THREE TIMES THAT REQUIRED FOR TRANSPORTING PETROLEUM PRODUCTS FROM PERSIAN GULF TO CALCUTTA. HIGH TRANSPORTATION COSTS, WHICH HAVE BEEN AGGRAVATED BY RISE IN PETROLEUM PRICES, IS ONE OF MAIN ELEMENTS IN HIGH FACTOR COST THROUGHOUT NEPALESE ECONOMY, WITH MAJOR IMPACT ON BOTH

DEVELOPMENT AND CONSUMER GOODS.

5. RISE IN PETROLEUM PRICES COMES AT EXTREMELY DISADVANTAGEOUS TIME FOR NEPAL. GIVEN SHORTAGES OF ESSENTIAL COMMODITIES IN INDIA AND EFFECT OF PRICE INCREASES ON INDIAN ECONOMY, INDIA IS NO LONGER IN POSITION TO SUPPLY MANY OF NEPAL'S IMPORT NEEDS. NEPAL THEREFORE MUST TURN TO THIRD COUNTRIES AS SOURCE OF IMPORTS. BUT BECAUSE OF ITS ISOLATION AND TRANSPORTATION DISADVANTAGE NEPAL HAS GREAT DIFFICULTIES IN SELLING IN THIRD COUNTRY MARKETS AND WILL NOT BE ABLE TO GENERATE SUFFICIENT HARD CURRENCY EARNINGS TO PAY FOR IMPORTS. AT SAME TIME, INCREASING POPULATION AND MIGRATION OF NEPALESE FROM HILL AREAS TO FERTILE TERAI IS DECREASING SURPLUS AGRICULTURAL PRODUCTION IN TERAI, ESSENTIAL TO GENERATE IC CURRENCY EARNINGS, WHICH ARE LIFE BLOOD OF NEPALESE ECONOMY, AS LARGE PROPORTION OF NEPAL'S IMPORTS ARE STILL OBTAINED FROM INDIA.

6. WHEREAS NEPAL'S FOREIGN EXCHANGE HOLDINGS OF ABOUT \$128 MILLION WERE PREVIOUSLY CONSIDERED ADEQUATE FOR NEPAL'S REQUIREMENTS, THIS IS NO LONGER TRUE. WITH INDIA HAVING INFORMED NEPAL IT CANNOT SUPPLY ANY PETROLEUM PRODUCTS EFFECTIVE JANUARY 1, NEPAL WILL HAVE TO OBTAIN ITS PETROLEUM FROM THIRD MARKETS AT WORLD PRICES UNLESS SPECIAL ARRANGEMENTS CAN BE WORKED OUT. (ACTUALLY, INDIA WILL CONTINUE TO SUPPLY PETROLEUM PRODUCTS TO NEPAL UNDER SWAP ARRANGEMENTS REPORTED KATHMANDU A-2 OF JANUARY 10, BASED ON NEPAL'S SUPPLYING COMPARABLE QUANTITIES OF CRUDE OR PRODUCTS OBTAINED ABROAD TO INDIA TERMINALS AT BOMBAY OR CALCUTTA.) THIS ALONE WILL COST APPROXIMATELY \$6 MILLION IN FOREIGN EXCHANGE IN 1974/75, WITH THE COST RISING TO AS MUCH AS \$15 MILLION DURING NEXT FISCAL YEAR WHEN NEPAL IS TOTALLY DEPENDENT ON THIRD COUNTRY SUPPLIES. LIMITED OFFICIAL USE

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PAGE 04 KATHMA 00291 170747Z

A LARGE PART OF NEPAL'S CEMENT REQUIREMENTS, ESTIMATED AT 100,000 METRIC TONS, WILL ALSO HAVE TO BE OBTAINED FROM THIRD MARKETS. IRON PRODUCTS, MOST OF WHICH WERE PREVIOUSLY OBTAINED FROM INDIA, WILL ALSO BE IMPORTED IN LARGE PART FROM THIRD COUNTRIES. GON ESTIMATES THAT IMPORTS OF CONSTRUCTION MATERIALS AND CONSUMER GOODS ALONE WILL AMOUNT TO ABOUT \$35 MILLION IN 1974/75. DURING FY 75/76, GON ESTIMATES THAT AMOUNT EQUAL TO ONE-THIRD OF NEPAL'S FOREIGN EXCHANGE RESERVES WILL BE SPENT ON CONSTRUCTION MATERIALS AND CONSUMER GOODS.

7. COMMENT: GIVEN INTANGIBLES, MEMORANDUM FALLS SHORT OF PROVIDING STATISTICAL BASE TO QUANTIFY ACCURATELY NEPAL'S CASE. THERE IS HOWEVER NO DOUBT THAT NEPAL IS IN A TIGHT SITUATION. WE BELIEVE THAT GENERAL REVIEW OF ECONOMIC SITUATION

AND OUTLOOK ARE SUFFICIENTLY CLEAR TO JUSTIFY GON'S CONCERN WITHOUT NEED TO CONSTRUCT CATHEDRAL OF SUPPORTING DATA, WHICH IN NEPAL IS VIRTUALLY IMPOSSIBLE TO OBTAIN. UNFORTUNATELY, THE PROGNOSIS WILL PROBABLY WORSE. NEPAL'S DEVELOPMENT EFFORTS WERE ALREADY HARD PRESSED TO STAY ABREAST OF INCREASING POPULATION AND THE GROWING IMBALANCE IN TRADE WITH INDIA. AS INDIA SUFFERS FROM WORLD ECONOMIC SITUATION, RISING PRICES, AND ITS OWN DOMESTIC PROBLEMS, SUPPLY SITUATION IN NEPAL WILL WORSEN. RECENT PRESS REPORTS THAT GOI IS CONSIDERING BAN OF ALL QUOTA EXPORTS TO NEPAL, SUCH AS STEEL, CEMENT, AND FERTILIZERS, REPORTED REFTEL APPEAR TO HAVE SOME SUBSTANCE AS MFA OFFICIAL HAS TOLD EMBASSY THAT GON NOW ENGAGED IN DISCUSSION WITH GOI CONCERNING CONTINUATION OF QUOTA EXPORTS. IF GOI MAKES DECISION TO CUT OFF, OR SIGNIFICANTLY REDUCE, EXPORT OF ADDITIONAL ESSENTIAL COMMODITIES TO NEPAL, PAYMENTS IN HARD CURRENCY WOULD OF NECESSITY BE AT HIGHER LEVEL AS NEPAL TURNS TO THIRD COUNTRIES. THERE IS ALSO POSSIBILITY THAT GOI MAY REQUIRE NEPAL TO PAY FOR IMPORTS OF QUOTA ITEMS IN HARD CURRENCY. WITH RESPECT TO PETROLEUM, RATIONING IS NOT REAL ALTERNATIVE FOR NEPAL GIVEN LOW LEVEL OF CONSUMPTION OF PETROLEUM PRODUCTS AND FACT THAT CONSUMPTION COULD NOT BE BUT BELOW THIS LEVEL WITHOUT SERIOUSLY AFFECTING THE ECONOMY. MOST OF PETROLEUM IMPORTS ARE NOW USED FOR COMMERCIAL TRANSPORTATION, INCLUDING AIRCRAFT FUEL, AND OTHER ESSENTIAL USES. IN ORDER TO ALLEVIATE PETROLEUM SUPPLY PROBLEM, GON HAS BEEN SEEKING LIMITED OFFICIAL USE

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PAGE 05 KATHMA 00291 170747Z

ARRANGEMENTS WITH PRODUCING COUTRIES. DELEGATION HAS JUST RETURNED FROM IRAN AND IS HOPEFUL OF WORKING OUT FAVORABLE FINANCIAL ARRANGEMENT WTH IRANIANS. EVEN IF SUCH ARRANGEMENTS SHOULD MATERIALIZE, NEPAL WILL STILL FACE EXTREMELY DIFFICULT BALANCE OF PAYMENTS SITUATION WITH REGARD TO BOTH THIRD COUNTRIES AND INDIA.

8. GON NOW ESTIMATES THAT TOTAL PAYMENTS FOR IMPORTS IN HARD CURRENCY IN FY 74/75 WILL APPROXIMATE \$45 MILLION AS COMPARED TO \$22 MILLION IN 1973/74. ADJUSTING FOR ADDITIONAL OUTFLOWS (INVISIBLES, LOAN REPAYMENTS) AND ESTIMATED INFLOWS, RASTRA BANK OFFICIALS BELIEVE FOREIGN EXCHANGE DEFICIT FOR YEAR WILL APPROXIMATE \$10-11 MILLION.

9. IN LIGHT OF THIS FURTHER ELABORATION OF GON POSITON WE AGAIN WISH TO EXPRESS OUR HPE THAT USG WILL BE ABLE TO SUPPORT NEPAL'S EFFORTS TO BE DESIGNATED AS "MOST SERIOUSLY AFFECTED COUNTRY." CARGO

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